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SUBJECT: SCENESETTER FOR CODEL RAHALL'S MAY 25-27 VISIT TO  
KAZAKHSTAN

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Summary  
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1. (SBU) Summary: Your visit to Kazakhstan comes at a particularly opportune time. With its thriving energy sector and recent selection as 2010 chairman of the Organization for Security and Cooperation in Europe (OSCE), Kazakhstan is showing increasing confidence on the international stage. The country is rightly proud of its achievements: a booming economy, rapidly expanding national capital, and largely harmonious multi-ethnic society. Kazakhstan has proven to be a reliable security partner and a steady influence in a turbulent region. The pace of democratic reform, however, has been slow, with political institutions, civil society, and the independent media still underdeveloped. Our fundamental strategic objective is a secure, democratic, and prosperous Kazakhstan that embraces market competition and the rule of law; continues partnering with us on the global threats of terrorism, WMD proliferation, and narco-trafficking; and develops its energy resources in a manner that bolsters global energy security. We would welcome your assistance in underlining to your Kazakhstani interlocutors the importance of maintaining a good investment climate, diversifying energy transport routes, and following through on the democratic reform commitments Kazakhstan made when selected to be 2010 OSCE chair. End Summary.

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Strong Growth, But Short- and Long-Term Challenges  
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2. (SBU) Kazakhstan is the region's economic powerhouse, with an economy larger than that of all the other Central Asian states combined. Economic growth averaged 9.2% a year during 2005-07, and the percentage of the population living below the subsistence level dropped from 28% in 2001 to under 10% at present. The energy sector is the dominant earner, with oil exports accounting for roughly a third of GDP. In the long term, Kazakhstan must focus on diversifying its economy, building up non-extractive industries, agriculture, and the service sector. In the short term, Kazakhstan is facing dual challenges of rising inflation, propelled by soaring international prices on food and agricultural commodities, and reduced economic growth, a reflection of the domestic impact of the global financial crisis -- which has caused a significant contraction in Kazakhstan's construction and real estate sectors. In April, the government imposed a temporary ban on the export of wheat in order to ensure adequate domestic supply and to keep domestic prices down on bread. (Note: Kazakhstan produces much more wheat than it consumes. We thus expect the export ban to be lifted once the next harvest comes in. End Note.) At the end of 2007, the government announced a \$4 billion assistance program for construction and real estate.

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An Emerging Energy Power  
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13. (SBU) Kazakhstan exported just over 60 million tons of crude oil in 2007 and is expected to be one of the world's top ten oil producers soon after 2015. The country also has significant natural gas reserves -- 1.8 trillion cubic meters is a low-end estimate -- but for now, natural gas exports are relatively small, just 10.2 billion cubic meters in 2007, in part because gas is being reinjected to maximize crude output. U.S. companies have significant ownership stakes in Kazakhstan's three largest oil and gas projects: Kashagan, Tengiz, and Karachaganak.

14. (SBU) Kashagan -- the largest oil field discovery since Alaska's North Slope and perhaps the world's most technically complex oil development project -- is expected to commence production in 2012. In January, the Kazakhstani government and the Kashagan consortium's international partners agreed on revised terms for the Kashagan contract which resulted in a new operatorship model, financial compensation to Kazakhstan for several years of production delays and significant cost overruns, and an increased ownership stake and management role for Kazakhstan's state oil and gas company, KazMunaiGas (KMG). Kashagan's current equity stakeholders are as follows: ExxonMobil (16.8%), Shell (16.8%), Total (16.8%), Eni (16.8%), KMG (16.8%), ConocoPhillips (8.4%), and Inpex (7.6%).

15. (SBU) Tengiz -- with a 50% Chevron stake, 25% ExxonMobil, 20% KMG, and 5% LukArco -- is the world's deepest operating "super-giant" oil field, with the top of the reservoir at about 12,000 feet deep. Crude production at Tengiz is expected to increase later this year from 400,000 barrels per day to 540,000, once the project's second generation expansion comes on line. Karachaganak (with a 32.5% BP Group stake, 32.5% Eni, 20% Chevron, and 15% Lukoil) is one of the world's largest oil and gas condensate fields. Karachaganak

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produced 10.4 million tons of oil and 12 billion cubic meters of gas in 2007.

16. (SBU) The Kazakhstanis recognize they do not have the capability to exploit their oil and gas resources on their own, especially given the complexity of Kazakhstan's oil and gas projects. Kazakhstan thus continues to welcome foreign investment in energy exploration and production, and both the Kazakhstani government and the international companies are committed to an enduring relationship. That said, Kazakhstan has grown increasingly assertive in its energy sector in recent years, reexamining the terms of existing contracts, driving a harder bargain with prospective investors, and aggressively pursuing environmental and tax claims against international oil companies. (For example, the Tengiz consortium is currently fighting a \$300 million environmental fine for on-site storage of several million tons of sulfur. The consortium received all the proper permits for sulfur production, and maintains that no permits are necessary -- or available -- for sulfur storage.) In October 2007, President Nazarbayev signed legislation which gives the government the right to terminate a subsoil use contract if it determines that a company's actions violate Kazakhstan's national economic security interests. Nazarbayev has stressed publicly that the legislation would be not be applied retroactively, against contracts that already existed when the legislation went into effect.

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Bringing Energy to Market  
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17. (SBU) With major production increases on the horizon, Kazakhstan must develop additional transport routes to bring its oil and gas to market. Our policy is to encourage Kazakhstan to seek diverse routes, which will ensure the country's independence from transport monopolists. Currently, the bulk of Kazakhstan's crude oil is exported via Russia, including through the Transneft system and the independently-owned Caspian Pipeline Consortium (CPC) pipeline, in which Chevron holds a 15% interest. Near-term crude production increases are likely to flow by rail through Russia, by tanker across the Caspian Sea to Baku, and through the CPC pipeline, should an agreement be reached with Russia on CPC expansion. We believe that a trans-Caspian oil pipeline must be built to handle later

production growth; however, Kazakhstan is reluctant to openly pursue this option in the absence of an agreement on delimitation of the Caspian Sea among the five Caspian littoral states. Moving increased volumes of Kazakhstani oil from Baku onward is also a challenge, and will likely require expansion of existing pipelines or construction of new ones that run through Georgia, such as Baku-Tbilisi-Ceyhan. Over 90% of Kazakhstan's limited gas exports currently flow through Russia. Kazakhstan hopes to export 5 billion cubic meters of gas annually to China by 2009.

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Democratic Development Lags  
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¶8. (SBU) While the Kazakhstani government articulates a strategic vision of democracy, it has lagged on the implementation front. This in part reflects the political reality that President Nazarbayev remains extraordinarily popular, while the opposition is weak and fractured. It also is a result of the government's resistance to fully competitive political processes. In May 2007, significant amendments were adopted to Kazakhstan's constitution which were touted as strengthening parliament, but also removed terms limits on Nazarbayev. In parliamentary elections held in August 2007, Nazarbayev's Nur Otan party received 88 percent of the vote and took all the seats in parliament. The OSCE election observation mission concluded that the elections did not meet OSCE standards.

¶9. (SBU) While Kazakhstan's diverse print media includes a plethora of opposition papers sharply critical of the government and of Nazarbayev personally, the broadcast media is almost exclusively in government hands and maintains a pro-government line. Several opposition web-sites were temporarily shut down by the government in late 2007 for uploading recordings of embarrassing conversations between senior government officials that were apparently made by Nazarbayev's former son-in-law, Rakhat Aliyev, who was recently convicted in absentia of plotting to overthrow Nazarbayev. Since mid-April, the Kazakh- and English-language websites of Radio Free Europe/Radio Liberty (RFE/RL) have been inaccessible in Kazakhstan. On May 20, RFE/RL issued a press release which maintained that the Kazakhstani government likely blocked the sites deliberately. We have raised the issue with senior Kazakhstani officials, but it remains unresolved.

¶10. (SBU) When Kazakhstan was selected as 2010 OSCE chairman at the  
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OSCE ministerial in Madrid in November 2007, Kazakhstan publicly committed to undertake several democratic reforms: specifically, that by the end of 2008, it would amend its election and media legislation to better meet international standards and liberalize registration procedures for political parties and media outlets. Kazakhstan also promised to support the OSCE's "human dimension" and preserve the mandate of the OSCE's Office of Democratic Institutions and Human Rights (ODIHR), including its critical role in election observation. The government has recently initiated working groups with participation from the political opposition and NGOs to discuss amendments to the election and media legislation. Ensuring that Kazakhstan follows through on its so-called "Madrid commitments" is one of our bilateral priorities for 2008.

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Iraq and Afghanistan  
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¶11. (SBU) Kazakhstan is the sole Central Asian country participating in Operation Iraqi Freedom (OIF). Since August 2003, the Kazakhstanis have maintained a military engineering unit at FOB Delta in Al-Kut (Wasit province) which has disposed of over 4.5 million pieces of unexploded ordnance. The unit also provides training to Iraqis in ordnance destruction. Kazakhstan is an important partner for Afghanistan's Operation Enduring Freedom (OEF). To date, Kazakhstan has facilitated over 4000 cost-free overflights for U.S. military aircraft supporting OEF. Kazakhstan is also providing Afghanistan with \$2.88 million in assistance in 2008, which is being used for food and seed aid and to construct a

hospital, school, and road. The Kazakhstanis are encouraging their private sector to seek out investment opportunities in Afghanistan, and have indicated that they want to make Afghanistan a focal point for their OSCE chairmanship.

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Non-Proliferation Cooperation  
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¶12. (SBU) Non-proliferation cooperation has been a hallmark of our bilateral relationship since Kazakhstan became independent and agreed to give up the nuclear arsenal it inherited from the USSR. Our bilateral Cooperative Threat Reduction (CTR) program has facilitated the dismantlement of Kazakhstan's intercontinental ballistic missile launchers, closure of test tunnels and boreholes at the former Soviet nuclear test site in Semipalatinsk, and elimination of an anthrax weapons production facility. Several critical CTR programs are ongoing, including the effort to secure and store spent fuel from a closed plutonium production reactor, as well as a biological threat reduction program aimed at ensuring effective Kazakhstani control of dangerous pathogens. In December 2007, the U.S. and Kazakhstan agreed to extend our bilateral umbrella agreement for the CTR program for an additional seven years. However, the Kazakhstanis still have to ratify the extension. In the interim, we have faced difficulties in receiving the tax and customs exemptions necessary for us to continue uninterrupted implementation of the CTR program.

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Relations With Russia and China  
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¶13. (SBU) The Kazakhstanis continue to deftly balance relations with Russia, China, and the U.S., and view the U.S. as a critical counterweight to their two very powerful neighbors. Social, cultural, and personal links help provide Russia with unmatched influence in Kazakhstan. Kazakhstan's population is approximately one-third ethnic Russian, and Russian remains the dominant language of the country. The most popular TV stations provide a heavy diet of programming from Russia, and the most widely-read newspapers cover events in Russia closely (and rarely unfavorably). Nazarbayev and Putin met more than 15 times over the last two years. New Russian President Medvedev is visiting Kazakhstan during May 22-23, his first trip abroad as president -- a clear signal of the importance Russia attaches to its relationship with Kazakhstan. Relations with China have strengthened as fears of Chinese encroachment have largely receded. Kazakhstan-China trade grew by 66% in 2007. China is also a major player in Kazakhstan's energy sector. A Kazakhstan-China oil pipeline has an annual capacity of ten million tons of crude, with capacity to double when its expansion is completed.

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